BULK PETROLEUM INVENTORY MANAGEMENT

Review and Discussion of the Inventory Management Plan (IMP)

April 2004

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Bulk Petroleum IMP Review

- Implements DoD policy for bulk petroleum inventories
  - Chapter 11, DoD 4140.25M governs
  - Basis for Defense Working Capital Fund (DWCF) funds programmed for holding (not selling) inventory
  - Basis for Combatant Commanders to know an important part of how DESC will support their wartime needs
  - Basis for DESC to operate in peacetime
    - Amount purchased driven by inventory vs. levels
    - Amount ordered and moved driven by inventory vs. levels
- Subject of continuing DoD IG interest
  - 1995 report led to significant Europe drawdown
  - 2003 report expressed concern over not publishing IMP

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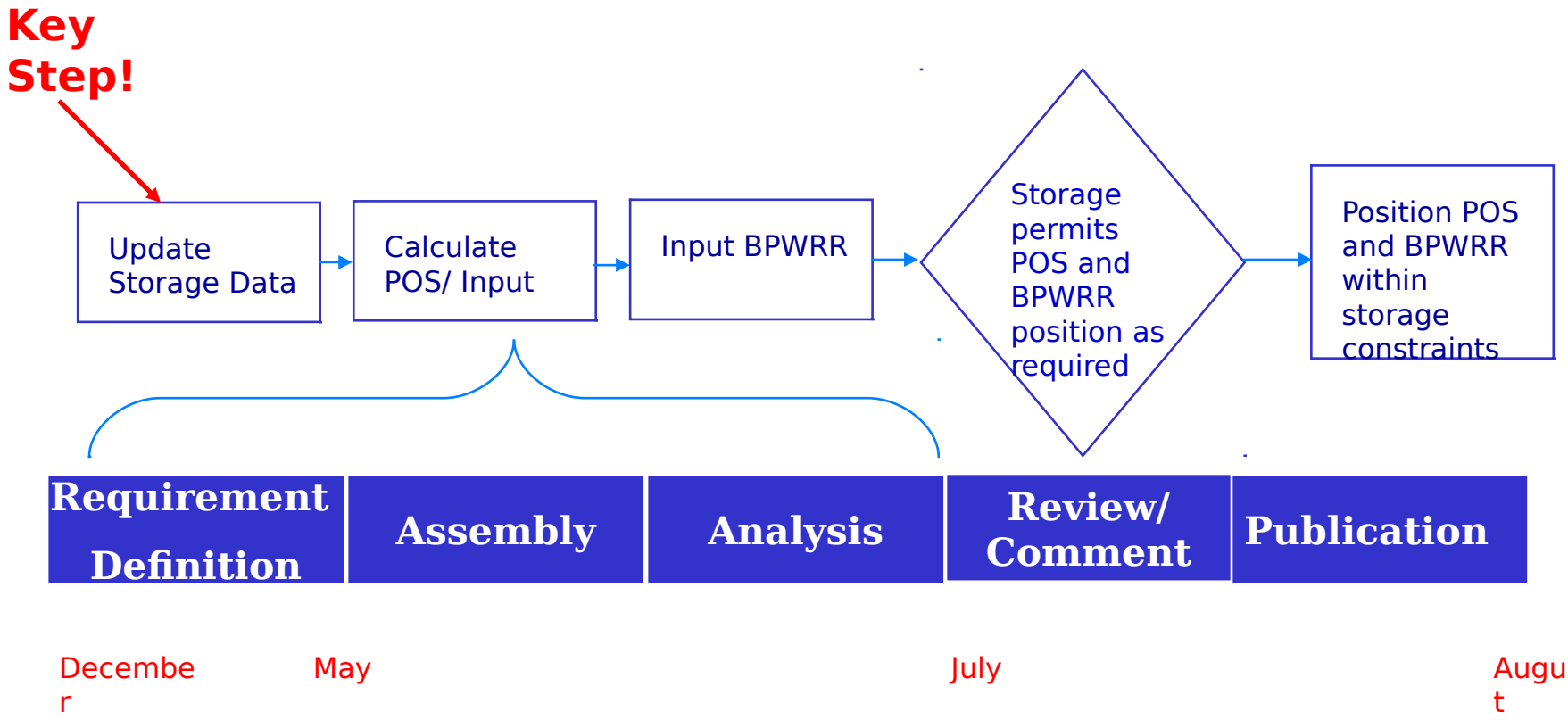
Bulk Petroleum IMP Preparation Process



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EUCOM Bulk Petroleum Inventory Comparison

(in millions of barrels)

Product	FY 01 IO (EUCOM + JFCOM)	FY 04 IO (EUCOM)	Difference
JP8	9.17	7.27	(1.89)
JP5	0.42	0.60	0.18
F76	0.86	0.90	0.03
Other	0.04	0.07	0.03
TOTAL	**10.49**	**8.84**	**(1.64)**

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FY 05 Bulk Petroleum IMP EUCOM Issues

- JP8 Requirements
  - Ensure that all ‘flow through’ requirements are identified
  - Increase in BPWRR could reduce augmented safety levels (ASLs) now held
- F76 Requirements
  - Ensure that requirements identified do not propose stockage of products for commercial vessels
  - Subject of 1995 DoD IG finding
- Role of USN Oiler inventories now DLA-owned
  - Currently carried separately from IMP values
  - DESC proposes to consider as intransit inventory
- Continue current working relationship with DESC Europe and EUCOM JPO

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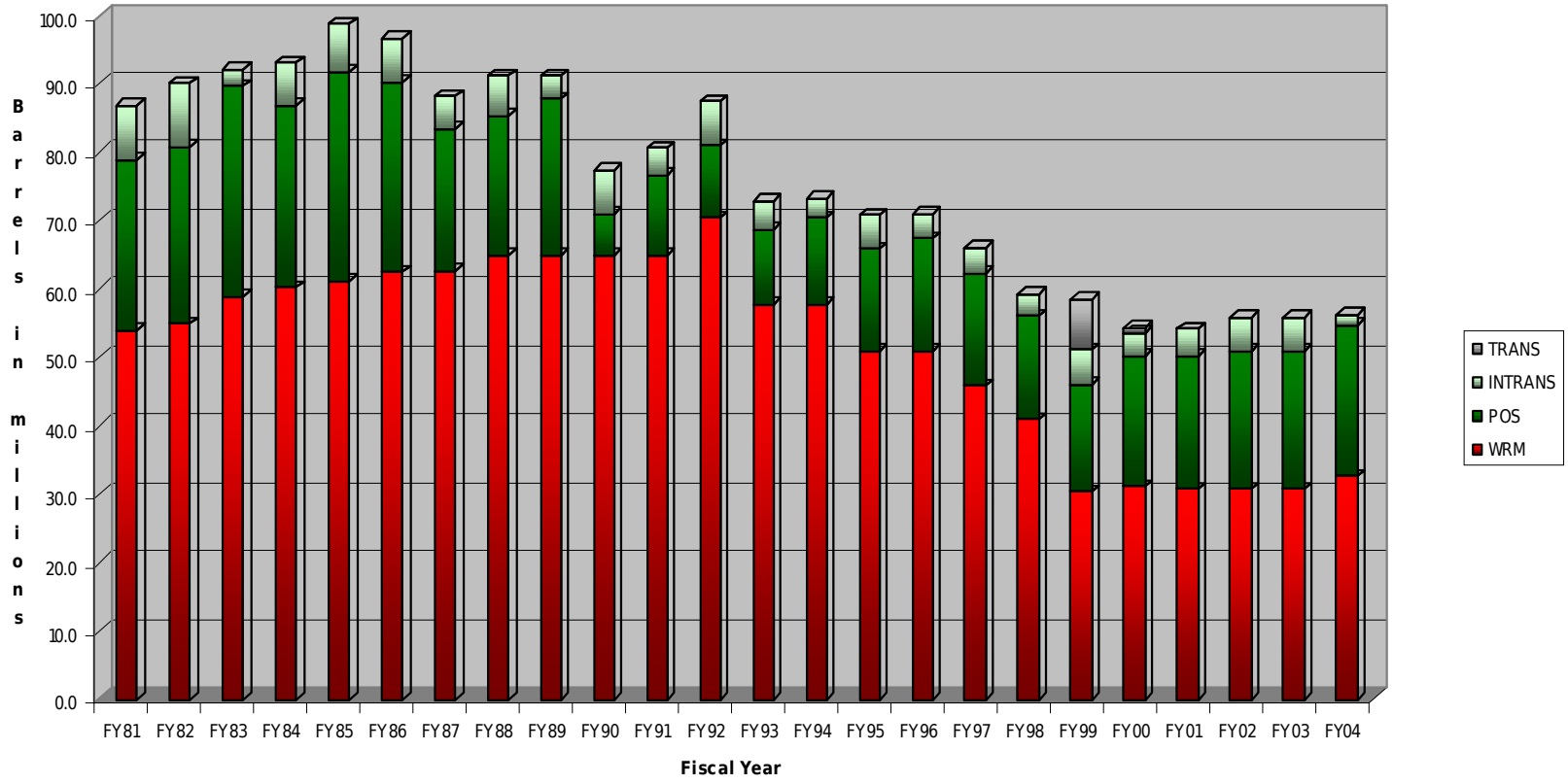
Bulk Petroleum Inventory Worldwide History



Does not include 3.0 million barrels of commercial ground products capitalized 1 Oct 2001

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Days of Supply (DOS)

- Revised and implemented in FY 04 IMP
  - First revision since 1993
  - Drive Bulk Petroleum War Reserve Requirements (BPWRR)-specific values are classified SECRET
  - First time values are product specific with specific components for lead time and transportation
  - Are generally higher, especially for JP5 and F76
    - No significant increases for JP8 since it mirrors commercial JA1 specification except in CONUS, where Jet A is standard
    - Reflect reduced capacity and flexibility in current bulk petroleum market, especially for specialty fuels such as JP5 and F76
- With some exceptions, net overall impact was neutral given other ongoing reductions

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Peacetime Operating Stock (POS)

- Augmented Safety Levels (ASLs)
  - Designed to ensure product is available for sales when we believe standard SL doesn't
  - Worldwide reduction (FY 01 to FY 04): 3.2 million barrels
- Safety Levels
  - Current policy calls for 5 days of mean demand in CONUS, 15 days of mean demand overseas
  - While this policy does not reflect current reality, needed technical support to change it is not expected.
- Economic Reorder Quantity (ERQ)
  - Largest parcel which is evaluated for bulk fuel bids
  - Only ½ counts as part of inventory objective

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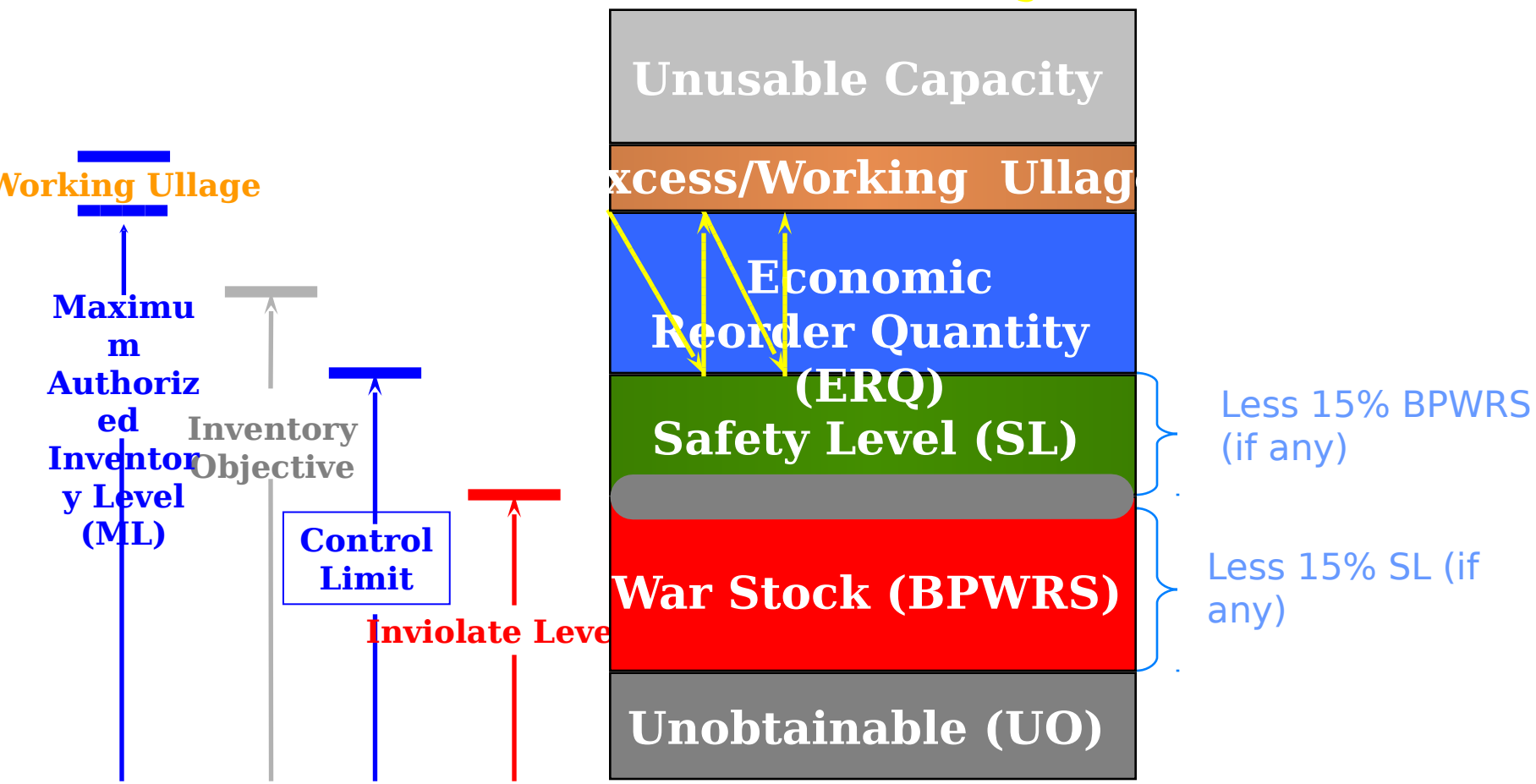
DLA Owned Bulk Petroleum Inventory

Current Policy



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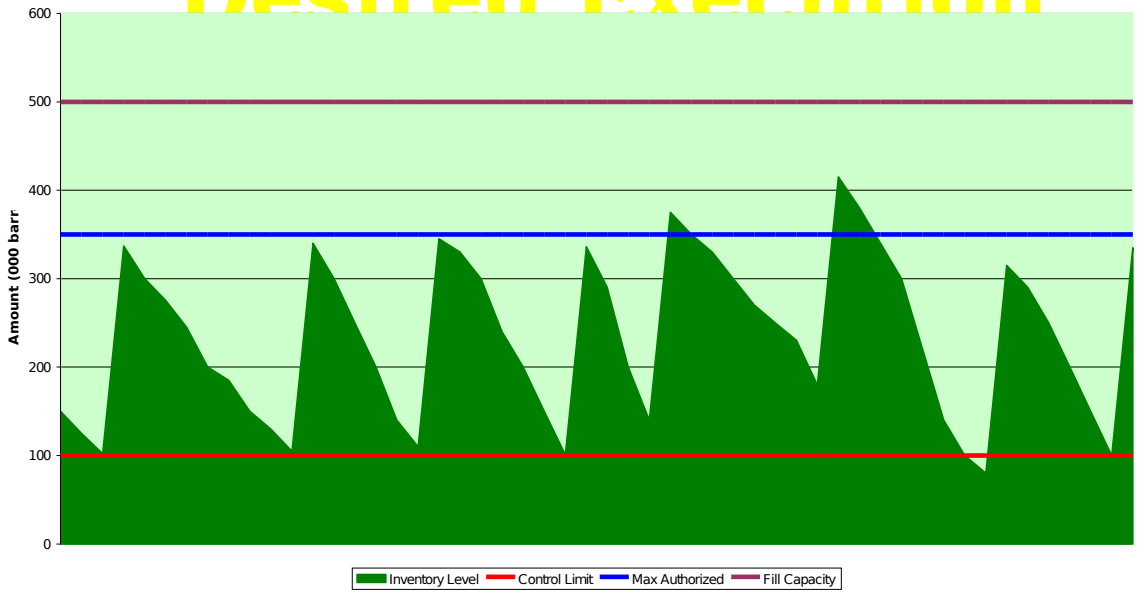
Bulk Petroleum Inventory Management Desired Execution



- Full ERQ-minimizes transportation expense
- Infrequent CL penetration-protects BPWRS
- Infrequent ML penetration-least risk of ‘stock-out’

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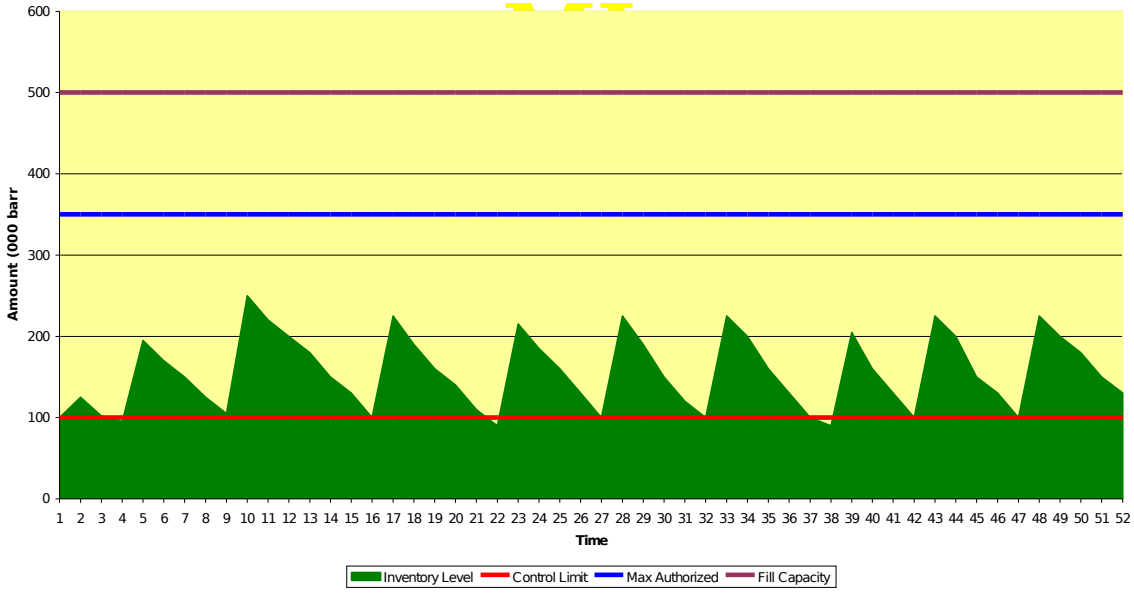
Bulk Petroleum Inventory Management Concern-DFSP Not at ML



- Never full ERQ-increases transportation cost
- Never approaches ML (IO is ML in this case)
  - Does decrease inventory holding cost
  - Also increases risk of ‘stock-out’

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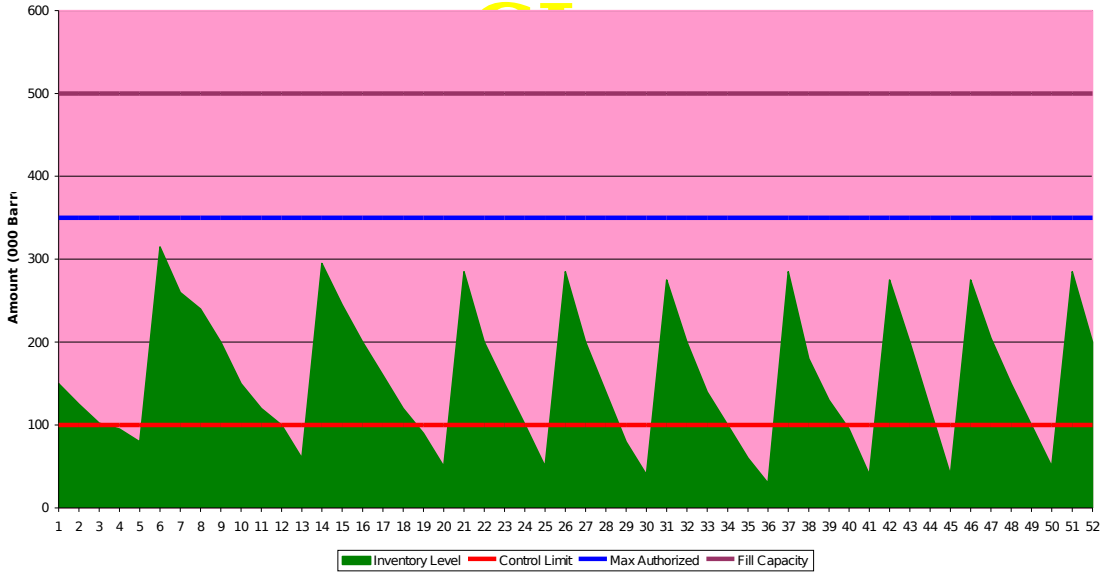
Bulk Petroleum Inventory Management Concern-DFSP below ROL



- Near full ERQ, but timed never to reach ML
- Not optimal in any regard (transportation or inventory)
- Increases risk
  - Of ‘stock-out’
  - Of BPWRS penetration

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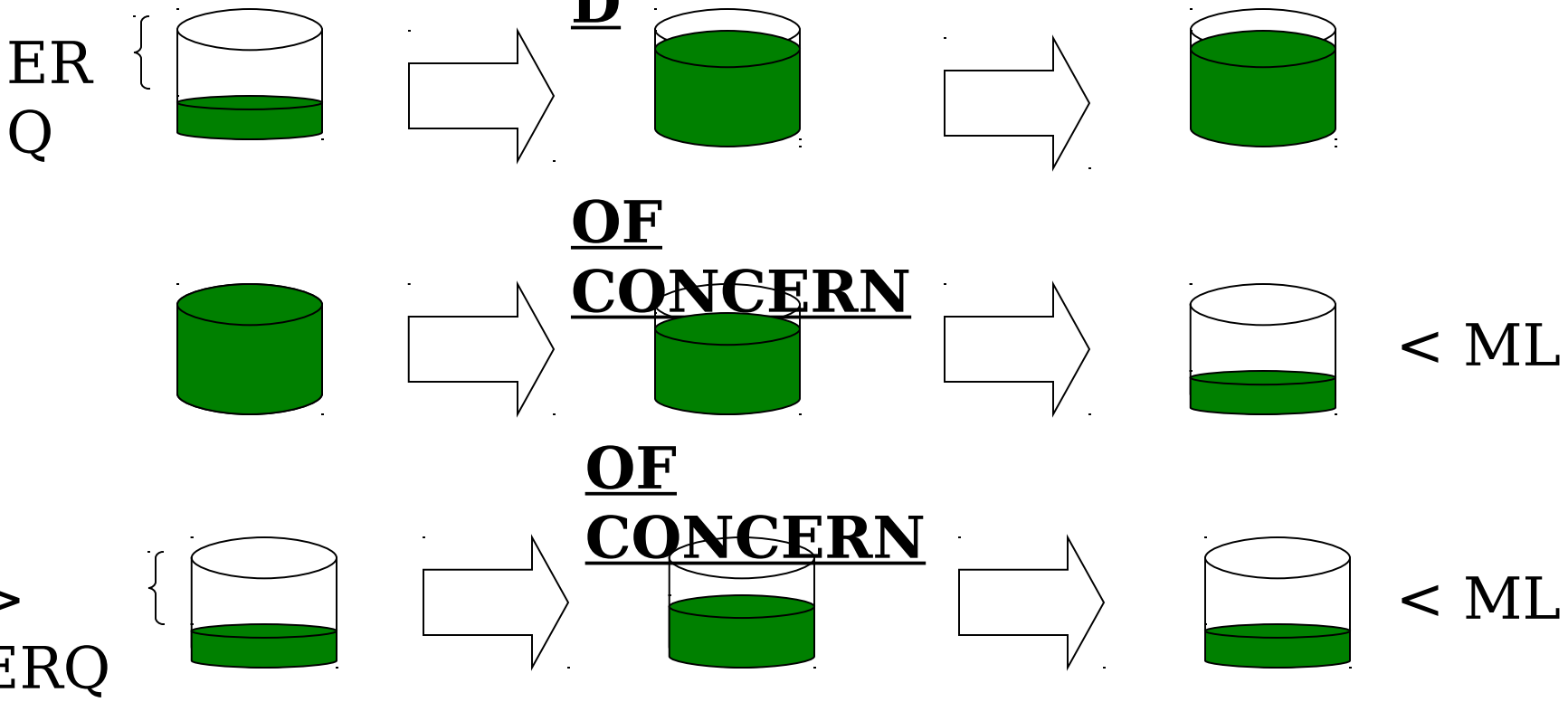
Bulk Petroleum Inventory Management Multiple DFSP Systems



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DFSP MANAGEMENT

- Order/slate in Economic Resupply Quantity (ERQ)
- Reach Maximum Level (ML) after every receipt
- Maintain inventory Between Control Limit (CL) & ML
- Ensure ullage is available for full scheduled receipts
- Report inventory level deviations to DESC region:
  - Below Minimum Level
  - Above Maximum Level
- Not expected to maintain Inventory Objective (IO) level at all times (on average: one half of the time)

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DESC REGIONAL MANAGEMENT

- Provide readiness indicator for the Combatant Commander and performance indicator for DESC
  - Inventories Below Control Limit/Inviolate Level
  - Inventories Above Maximum Level
- Continuously review DFSP inventories and storage data
  - Ensure accurate 1884/DFAMS/ED reporting
  - Provide input on storage projections
  - Advise DESC of problems and proposed solutions
- Order to meet contract commitments to suppliers
  - Ensure fuel ordered on ratable basis
  - Meet contract terms and minimum commitments

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DESC BULK FUEL MANAGEMENT MEASURES

- Publish and maintain Inventory Management Plan, or IMP (DESC-BI) which establishes levels
- Execute IMP and budgetary guidance (DESC-BI)
  - Purchase and distribute fuel to meet customer requirements and prescribed inventory levels
  - Work through DESC regions and tanker branch (DESC-BIT) to ensure worldwide inventory meets budgetary and readiness goals
    - Manage worldwide fuel inventories between minimum and maximum levels
    - Make adjustments to purchases and levels as required
      - Drawdown or buildup
      - Adjusted levels

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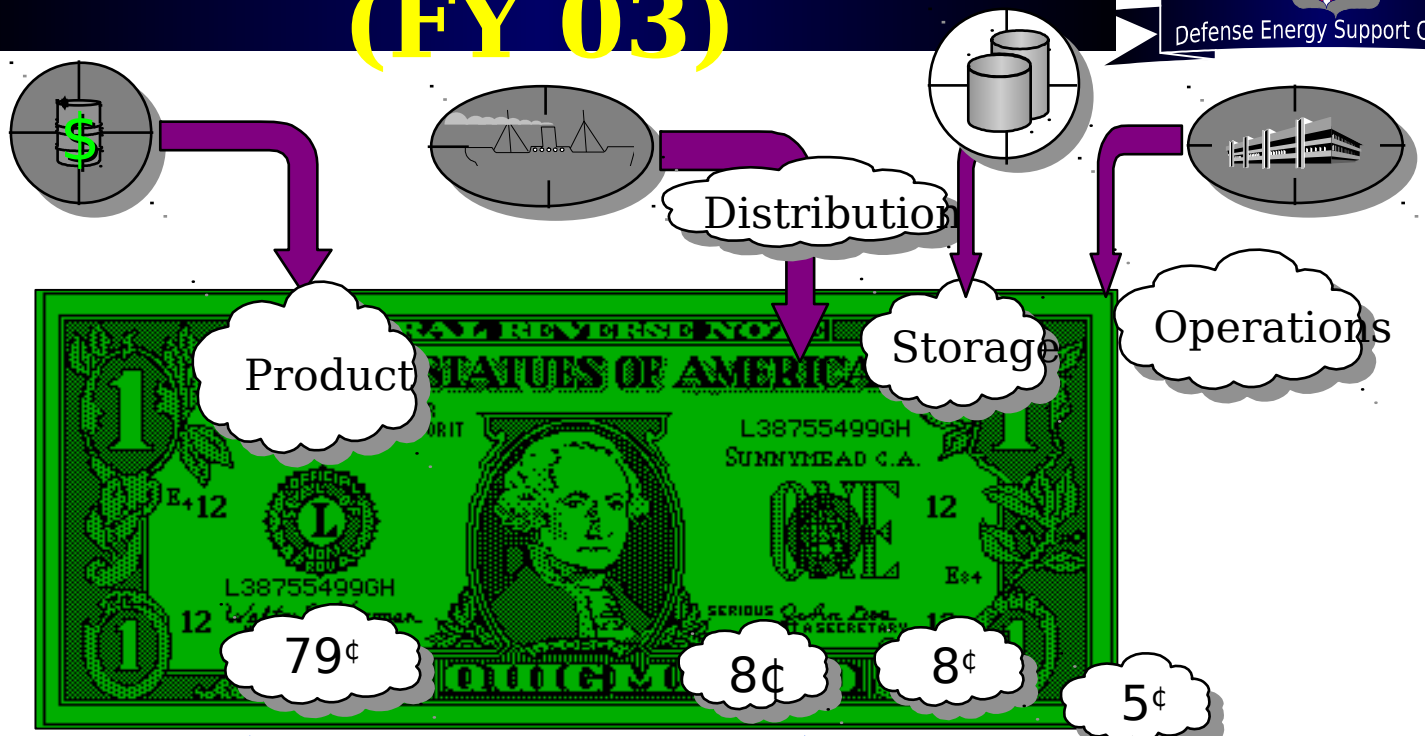
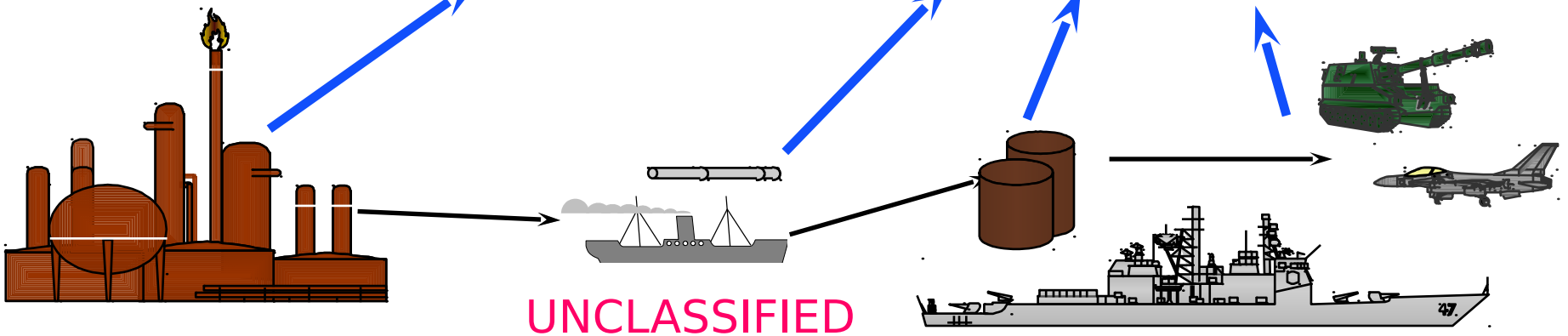
DESC COSTS
Dollar Breakdown
(FY 03)

For Over 60 Years

Defense Energy Support Center





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